1988

Unlocking the Maze : A CPA's Guide to Preparing Your 1988 Tax Return

American Institute of Certified Public Accountants. Communications Division

ORGANIZATION IS EVERYTHING

Filing a tax return doesn't have to be a traumatic experience. Start early and take time to organize yourself. Sort your receipts and records into individually labeled folders. And don't hesitate to ask for help. A CPA can be the key to unlocking the maze of tax reform.

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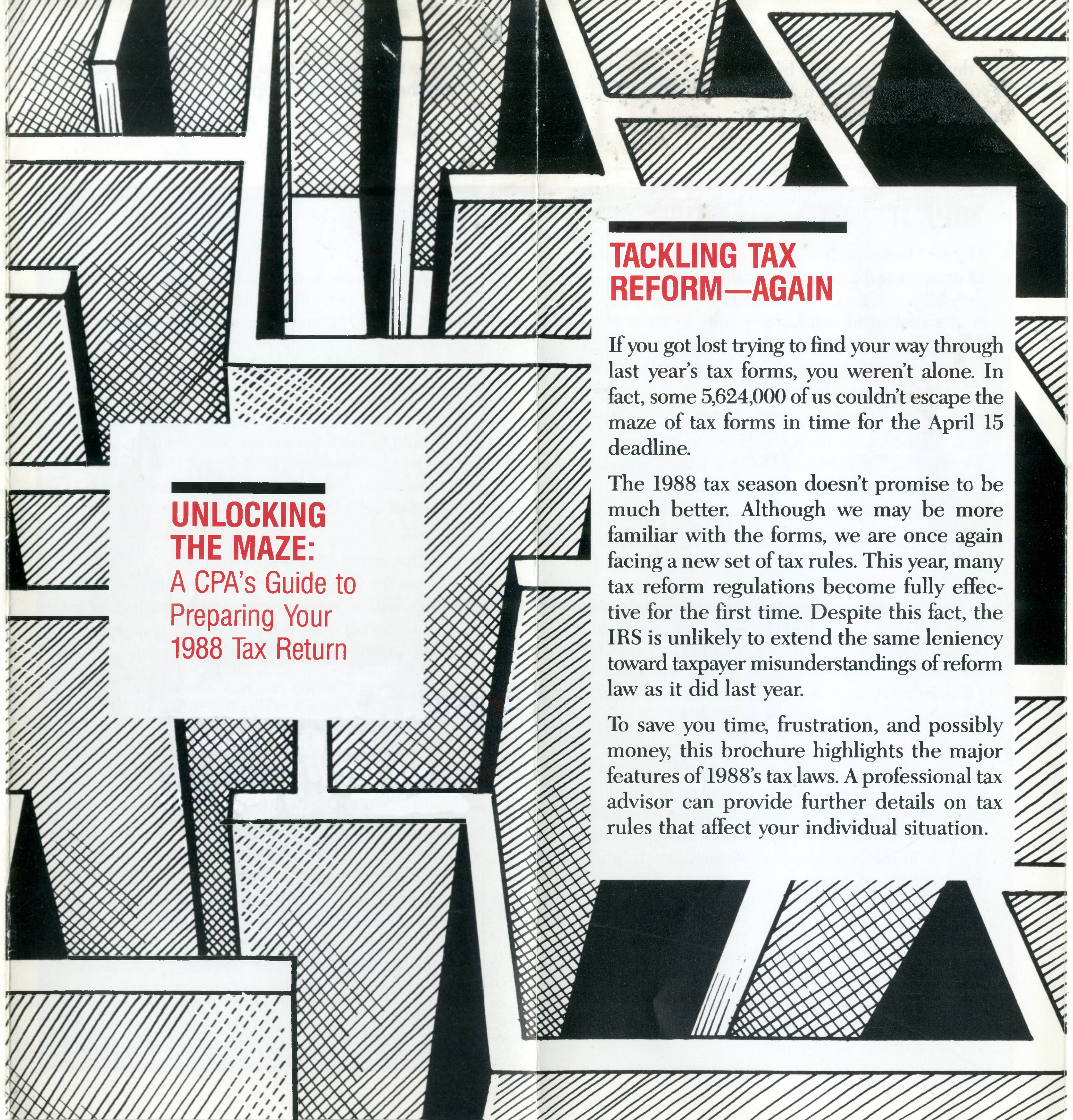
AICPA "The Measure of Excellence"
American Institute of
Certified Public Accountants
Communications Division
1211 Avenue of the Americas
New York, N.Y. 10036–8775



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TACKLING TAX REFORM—AGAIN

If you got lost trying to find your way through last year's tax forms, you weren't alone. In fact, some 5,624,000 of us couldn't escape the maze of tax forms in time for the April 15 deadline.

The 1988 tax season doesn't promise to be much better. Although we may be more familiar with the forms, we are once again facing a new set of tax rules. This year, many tax reform regulations become fully effective for the first time. Despite this fact, the IRS is unlikely to extend the same leniency toward taxpayer misunderstandings of reform law as it did last year.

To save you time, frustration, and possibly money, this brochure highlights the major features of 1988's tax laws. A professional tax advisor can provide further details on tax rules that affect your individual situation.

THE NEW TAX RATES

The 1988 tax rates are the lowest we've seen since 1931. Basically, there are two tax brackets: 15 percent and 28 percent. However, the benefit of the 15 percent bracket phases out for single taxpayers earning $43,150 to $89,560 and married taxpayers earning $71,900 to $149,250. These individuals pay a five percent surtax—making their top marginal tax rate 33 percent.

Caution: Long-term capital gains are now taxed at the same rates as ordinary income, which can go as high as 33 percent.

YOUR STANDARD DEDUCTION

1988 also introduces a new, and substantially higher, standard deduction. Remember, the standard deduction is available only to taxpayers who do *not* itemize.

Filing Status	Standard Deduction
Married, Filing Jointly	$5,000
Married, Filing Separately	$2,500
Head of Household	$4,400
Single	$3,000

If you are blind or age 65 or older, you are entitled to an extra standard deduction of $600 if married, and $750 if single. The amount doubles if you are both elderly and blind.

A HIGHER EXEMPTION

An exemption is the amount you can subtract from your taxable income for each person you support—including yourself. In 1988, the exemption amount increases by $50 to $1,950.

Caution: If you claim an exemption for your child or any other dependent, that person may no longer claim his or her own exemption.

TO ITEMIZE OR NOT TO ITEMIZE

Here's a simple test to determine whether or not you should itemize. Add up your itemized expenses. If they total more than your standard deduction, you should probably itemize. Don't give up if your itemized expenses come to just a few dollars more than your standard deduction. A qualified tax advisor may be able to save you hundreds of dollars more by uncovering deductible expenses of which you are unaware.

YOUR ADJUSTED GROSS INCOME

If you decide to itemize, you will have to calculate your adjusted gross income (AGI) carefully, since this figure determines the amount of many other deductions, including those for medical and miscellaneous expenses. To find your AGI, simply take your gross income and subtract those adjustments, such as IRA contributions and alimony payments, listed on the first page of Form 1040.

THE TAX VALUE OF IRA CONTRIBUTIONS

To lower your adjusted gross income and thus increase the amount of your itemized expenses, make a deductible IRA contribution. As long as you do not actively participate in an employer's retirement plan, you can deduct an IRA contribution of up to $2,000. Check your W-2 form or ask your employer to clarify your status.

If you *are* covered by a retirement plan, you may still be able to deduct all or part of your contribution. Married couples with an AGI of $40,000 or less and single individuals with an AGI of $25,000 or less may take the full deduction. For every $1,000 in income over these ceilings, however, the deduction decreases by $200. Consequently, if you're single and earn at least $35,000, or you're married and earn at least $50,000, you lose the deduction completely.

YOUR ITEMIZED DEDUCTIONS

Home Mortgage Interest is deductible on loans of up to $1 million as long as the funds are used to purchase a primary or secondary home. Interest is also deductible on home equity loans of up to $100,000, providing that the amount of the loan plus your existing mortgage debt doesn't exceed your home's fair-market value.

Points paid to secure a mortgage in 1988 may likewise be fully deductible this year if you paid the points with personal funds.

Losses from Rental Property are now considered "passive" and thus can be deducted only from passive income. However, if you actively participate in renting your property, and your adjusted gross income is $100,000 or less, you can deduct rental losses of up to $25,000 from your regular income. For owners with AGIs over $100,000, the $25,000 allowance is reduced by 50 cents for every dollar of income above $100,000.

Miscellaneous Expenses are deductible to the extent that they exceed two percent of your adjusted gross income. Miscellaneous expenses include such items as union dues, tax preparation fees, uniforms, qualified educational costs, and job-hunting expenses.

Personal Interest is only 40 percent deductible in 1988, down from 65 percent last year. The deductible amount will fall to 20 percent in 1989, and will be eliminated in 1991.

Medical Expenses are deductible to the extent that they exceed 7.5 percent of your adjusted gross income. When totaling unreimbursed medical expenses, don't overlook payments for insurance premiums, dental work, eyeglasses, or prescription drugs.

Charitable Contributions are still deductible for taxpayers who itemize. Don't forget that if you give more than $500 in noncash property, such as stocks or artwork, you must file Form 8283.

Moving Expenses related to your job are deductible only if you itemize. Eligible expenses may include a renter's lost security deposit, fees charged by a moving company, and transportation costs for traveling to your new residence.

State and Local Income Tax, unlike state sales tax, remains deductible.

Property Tax is also still deductible.

Impairment-Related Work Expenses may be deducted without regard to the two percent rule. Included in this category are necessary expenses for services which enable you to conduct your business. For example, if you are confined to a wheelchair, you may deduct the cost of hiring someone to assist you when traveling on business trips.

FILING TIPS FOR SPECIAL TAXPAYERS

- **Children Under Age 14** can use $500 of their standard deduction to offset the first $500 of unearned income, such as interest and dividends. The next $500 in unearned income is taxed at the child's tax rate, usually 15 percent. Any unearned income above $1,000 is taxed at the parents' rate. Does it still pay to accumulate savings in your child's name? Definitely. You can invest $14,000 in a certificate of deposit paying approximately 7.1 percent interest before reaching the $1,000 limit.
- **Taxpayers Age 65 or Over** have a number of valuable tax breaks. For example, if you and your spouse both qualify for the credit for the elderly or the disabled, you may be able to reduce your tax bill by up to $1,125. In addition, if you are at least 55 years old, you may want to take advantage of the once-in-a-lifetime exclusion of $125,000 in gain from selling your primary residence.
- **Dependent-Care Tax Credit** is available to taxpayers who pay someone to take care of their dependent child, parent, or spouse while they are working. To be eligible, the spouse or dependent must be unable to take care of himself or herself. The amount you can deduct depends on your adjusted gross income, but can go as high as $720 for one dependent.
- **Self-Employed Taxpayers** may deduct 25 percent of their medical insurance costs from their gross income—without regard to the 7.5 percent floor on medical expenses.
- **Students** should note that scholarships or fellowships awarded after August 16, 1986 are tax-free only for degree candidates who use the funds for tuition and course-related expenses. You can no longer exclude from gross income any money awarded for such expenses as room, board, and travel. Neither can you exclude any funds received in return for teaching or research services—even if they are required for the degree.